CONFUSED THINKING

by Steve Brown

Last week was a week of tragic-comedic parallelism. At first, 700 Club television evangelist Pat Robertson said Haitians long strings of troubles are a result of their historic "pact with the devil" that was done to win their independence from France. Now of all the unifying and uplifting things he could have said or quoted from the Bible, choosing to go with the "deal with the Devil" was amazingly short-sighted.

In similar confused thinking, NBC re-shuffled its late night talent of Jay Leno and Conan O'Brien, breaking contracts, hurting viewership, forcing O'Brien off the air and making NBC the laughing stock of the networks.

Unfortunately, the ridiculous moves didn't end there as later in the week, the Administration unveiled their "Financial Crisis Responsibility Fee" - essentially a punitive tax on large banks (over $50B) for the financial crisis. This new fee is expected to raise about $100B over the next 10Ys and is designed to a) target "the obscene bonuses at the very firms who owe their continued existence to the American people" (the President's words), and, b) meant to help the budget deficit. Out of all the things the Administration could have suggested, this one was also very short-sighted in our opinion.

While we are all for taxing large banks to make community banks more competitive, this proposal is just too absurd to support. For starters, a retroactive punitive tax to change future behavior is rarely a good idea, as the timing difference alone prevents banks from reacting the way the Administration desires. To that point, the proposal targets many banks that have already repaid TARP in full, or that plan to do so in 2010. Clearly, banks such as JP Morgan, BofA and others have fulfilled their obligations under TARP, so why levy another tax, forcing them to pay for other recipients of TARP such as AIG, GM and Chrysler?

If you set aside the fairness issue, the tax falls down on the policy side as well. One of the largest drags on the economy is the non-creation of credit, the cost of which is directly tied to funding. Does the President really believe that levying a new tax burden of $100mm on banks will make them more inclined to lend? Ironically, if you look at 4Q earnings from JP, Citi and others, it is the trading, investment banking, insurance and overseas profits that have generated the majority of the earnings. These more lightly regulated activities are all the areas that many in Congress hope to curtail because their "heightened level of risk." However, the tax helps support these less funding intensive areas, providing the exact opposite economic incentives than the Administration's stated agenda. Additionally, the tax is flat and not graduated. If it were graduated, at least there would be some incentive to get smaller.

Further, the calculation has little correlation to risk. The tax is calculated by applying 15bp to uninsured liabilities, calculated as assets less Tier 1 capital minus insured deposits. For the average large bank, this would increase the overall cost of funds by an estimated 7bp. Because this fee is similar to the recent FDIC assessment for insured deposits, the path is clear for most banks to pass these higher fees directly to the consumer and businesses in the form of lower deposit rates.

If the tax was designed to discourage the taking of risk by limiting bonuses, it will do nothing of the sort. The tax will slow lending, reduce earnings for depositors and do nothing to advance the Administration's policy goals of preventing the next financial crisis. The good news is the fact that the events of the past week lead to a tidy solution - bump Pat, put Leno at the 700 Club and move O'Brien to the Treasury.

BANK NEWS

3 Banks Closed (4 YTD)

The FDIC closed the following on Friday: [1] Town Community B&T ($70mm, IL) was sold to First American Bank [assumed 1 branch, all deposits (for no premium) and $68mm in assets (82% under loss share)]; [2] St. Stephen State Bank ($25mm, MN) was sold to First State Bank of St. Joseph [assumed 2 branches, all deposits (for no premium) and $20.4mm of assets under loss-share]; [3] Barnes Banking Company (UT) was put into an FDIC-created Deposit Insurance National Bank of Kaysville (DINB), which will remain open until Feb 12 and is being operated by Zions.

Bank Earnings

JPMorgan Chase: The bank reported 4Q profits of $3.28B, totaling profits of $11.7B for 2009. Net revenue fell 12% QOQ while the retail banking arm posted a net loss of $400mm. Credit losses (outside of securitizations) totaled $7.8B, down slightly from $8.1B. Citigroup Inc.: Posted a $7.6B loss and ended a three quarter profit streak. The loss was driven by costs to exit TARP, offset somewhat by a 5.9% increase in revenue from trading. Meanwhile, net credit losses were $7.13B, down about 11% from the prior quarter. Loan loss reserves are 6.1% of total loans.

Bank Bankruptcy

The Senate is reportedly considering creating a special bankruptcy court for banks and rules that would require counterparties, shareholders and creditors to share in the loss if a bank fails.